



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE
SIGNIFICANT SERVICE CENTER ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL-PHILADELPHIA, (SMALL
BUSINESS/SELF-EMPLOYED) CC:SB:2:PHIL

FROM: Assistant Chief Counsel (Employee Benefits)
Tax Exempt and Government Entities
CC:TEGE:EB

SUBJECT: Request for Significant Service Center Advice
Earned Income Credit

This is in response to your request for Significant Service Center Advice, dated December 21, 2001, and subsequent correspondence. The issues relate to the disallowance periods for the Earned Income Credit (EIC) under section 32(k) of the Internal Revenue Code (the Code) with respect to three factual scenarios. In accordance with section 6110(k)(3), this Significant Service Center Advice should not be cited as precedent.

ISSUES

1. Under what circumstances can section 32(k) restrictions be imposed?
2. Is a taxpayer's failure to respond to a request from the Internal Revenue Service for substantiation and verification of a claimed EIC on an original return considered reckless or intentional disregard of the rules and regulations such that the taxpayer is prohibited from claiming the EIC for the next two taxable years under section 32(k)(1)(B)(ii) of the Code?
3. Is a taxpayer's response to a request from the Service for substantiation and verification of the EIC, where the response fails to provide adequate information substantiating or verifying the claim for EIC, considered reckless or intentional disregard of the rules and regulations such that the taxpayer is prohibited from claiming the EIC for the next two taxable years under section 32(k)(1)(B)(ii) of the Code?

4. If the Service may impose the 2-year ban for failure to respond or inadequate response, should the ban be separately stated on a notice of deficiency?

CONCLUSIONS

1. Section 32(k) restrictions are imposed where there is evidence of “reckless or intentional disregard of rules and regulations.” Because each case will be decided applying the fact-specific standard in the statute, any enumeration of specific factual scenarios would not be exhaustive or exclusive.
2. A taxpayer’s failure to respond to a request from the Service for substantiation and verification of EIC alone is not sufficient to be considered reckless or intentional disregard of the rules and regulations so that the taxpayer is prohibited from claiming EIC for next two taxable years under the provisions of section 32(k)(1)(B)(ii) of the Code.
3. A taxpayer’s failure to adequately respond to a request from the Service for substantiation and verification of EIC alone is not sufficient to be considered reckless or intentional disregard of the rules and regulations so that the taxpayer is prohibited from claiming EIC for next two taxable years under the provisions of section 32(k)(1)(B)(ii) of the Code.
4. Because, as stated above, the Service may not impose the 2-year ban for the mere failure to respond or an inadequate response, this question does not apply to those situations. In situations in which the 2-year ban applies, the section 32(k) ban can be separately stated on the notice of deficiency.

FACTS

Scenario 1

The taxpayer files a timely federal income tax return claiming the EIC based on two qualifying children. The return shows an overpayment, including the EIC. The overpayment is frozen and the return is selected for pre-refund examination. The Service sends the taxpayer a letter requesting verification and substantiation of the taxpayer’s claim for credit. The taxpayer fails to respond. The Service issues a statutory notice of deficiency disallowing the credit based on the taxpayer’s lack of substantiation or verification.

Scenario 2

The facts are the same, except the overpayment is refunded and the return is selected for post-refund examination.

Scenario 3

The taxpayer timely files a return, but does not claim the EIC. The taxpayer subsequently files an amended return claiming the credit. The amended return is examined. The taxpayer attempts to substantiate the credit. The Service determines that the information provided is inadequate and disallows the claim.

LAW AND ANALYSIS

Issues 1, 2 and 3

Section 32 of the Code allows a refundable credit to low-income taxpayers who meet certain income and eligibility requirements. The credit is available to taxpayers with one or more qualifying children and to taxpayers with no qualifying children.

Section 32(k)(1)(A) of the Code imposes a disallowance period for claiming the EIC on any individual who makes a fraudulent or reckless EIC claim. Section 32(k)(1)(B)(i) denies the credit for a period of ten taxable years after the most recent taxable year for which there was a final determination that the taxpayer's EIC claim was due to fraud. Section 32(k)(1)(B)(ii) denies the credit for a period of two taxable years after the most recent taxable year for which there was a final determination that the taxpayer's EIC claim was due to reckless or intentional disregard of rules and regulations.

Thus, for the ten-year ban, there must be a determination of fraud, and for the two-year ban, there must be a determination of reckless or intentional disregard of rules and regulations. The statute does not require that a fraud or accuracy-related penalty be asserted in order to deny the credit for a period of years.

Whether an EIC claim is fraudulent or due to reckless or intentional disregard of rules and regulations is determined on the basis of the facts and circumstances of each case.

A taxpayer's failure to respond (or failure to provide an adequate response) to a request for substantiation and verification of EIC does not, in and of itself, constitute reckless or intentional disregard of the rules and regulations so that the taxpayer is prohibited from claiming the EIC for the next two taxable years under the provisions of section 32(k)(1)(B)(ii). We are unaware of any rule or regulation mandating a taxpayer to respond to a request for substantiation and verification of the EIC. Accordingly, more facts are required to support a determination of reckless or intentional disregard of the rules and regulations. Nothing in the three factual scenarios outlined above supports such a proposition.

Issue 4

The section 32(k) ban can be separately stated on a notice of deficiency. The notice of deficiency for the determination year should advise the taxpayer of the ban and the reasons for it. The notices of deficiency for the ban years must specify that disallowance of the EIC is based upon the ban set out in section 32(k)(1) and must describe the taxpayer's conduct in the determination year (rather than the present year) giving rise to the ban.

If you have any further questions, please call _____ at _____

ALAN TAWSHUNSKY

By: _____
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Senior Advisor
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